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# MULTIMEDIA UNIVERSITY

## FINAL EXAMINATION

**TRIMESTER 2, 2020/ 2021**

### **BAC3624 – ADVANCED AUDITING**

(All Sections / Groups)

08 MARCH 2021  
9.00 a.m. – 12.00 p.m.  
(3 Hours)

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#### **INSTRUCTIONS TO STUDENTS**

1. This Question paper consists of 8 pages excluding cover page with **5** questions only.
2. Attempt ALL questions. The distribution of the marks for each question is given.
3. Write all your answers in the Answer Booklet provided.

**QUESTION 1 (20 marks)**

(a) Your firm acts as external auditor to Speed Berhad (Speed), a retail car dealer. During the course of your audit for the year ended 31 December 2020, you discovered that the company's sales manager, helped by the accounts clerk, has deliberately falsified details of the value of vehicles sold in order to increase his monthly bonus payments.

In respect to the above matter, contrast your responsibilities as an auditor, with those of the management of Speed.

(3 marks)

(b) You are the manager responsible for the engagement to review the financial information of Azam Berhad (Azam) on behalf of an external audit client, Bakti Berhad (Bakti), a listed company. Bakti requested the review as it intends to acquire the share capital of Azam. The audit junior currently working with you on the review engagement told you that, yesterday, he purchased shares in Bakti because he believes its share price will rise when the acquisition of Azam is announced. He also told you that he has informed his parents about the acquisition and has advised them to purchase shares in Bakti.

Explain the ethical issues arising in this situation and state the actions you and your firm should take.

(4 marks)

(c) You have completed the tests of controls in your audit. The only deviations found were that there was no evidence that one particular control had been operated in three cases out of 25 tested.

Explain what considerations will determine whether you are able to reduce the substantive procedures in the area of this control.

(2 marks)

(d) Your firm is the external auditor of Staygreen, a charity established to promote the protection of the environment. Staygreen raises income from the sale of food and drinks in cafes located in city centres and from donations made by individuals. The cafes are managed and staffed by unpaid volunteers. Donations are made to Staygreen through collection boxes located in each cafe and by post to Staygreen's headquarters.

Identify and explain THREE (3) key audit risks associated with your firm's audit of Staygreen's income.

(3 marks)

**Continued...**

(e) Your firm is the external auditor of Wangsa Berhad (Wangsa), a marketing agency, for the year ended 31 December 2020. During the audit of work in progress, you discover that 20% of the work in progress balance relates to completed marketing projects which were delivered to clients more than three months before the year end and had not yet been invoiced.

Prepare notes, in readiness for drafting your firm's report to the management of Wangsa, which outline the possible consequences of this significant internal control deficiency and provide recommendations to remedy the deficiency.

(4 marks)

(f) External auditors are required to obtain written representations from management when performing an engagement to examine prospective financial information.

List the representations that should be obtained and explain why they are required.

(4 marks)

(Total: 20 marks)

## QUESTION 2 (34 marks)

Your firm is the external auditor of Sporty and Healthy Berhad (SAH), a listed company, for the year ending 31 December 2020. SAH is a retailer of discounted branded sports footwear, clothing and accessories at up to 50% off their recommended retail price. SAH sells goods from 110 stores across Malaysia and through its own website which was launched on 1 January 2020. SAH owns a warehouse in Cyberjaya which holds goods prior to despatch to its stores and online customers.

You are the audit senior and the engagement partner has asked you to consider the following two key areas of audit risk:

- (1) Going concern
- (2) Provision for redundancy costs

The engagement partner provided you with the following extracts from the financial statements:

### Statement of profit or loss for the year ended 31 December

	2020 (estimated) RM'000	2019 (audited) RM'000
Revenue	200,000	220,215
Cost of sales	(130,000)	(134,007)
Gross profit	70,000	86,208
Loss before tax	(12,500)	(1,758)

Continued...

**Statement of financial position as at 31 December**

	<b>2020 (estimated)</b> <b>RM'000</b>	<b>2019 (audited)</b> <b>RM'000</b>
<b><u>Non-current liabilities</u></b>		
Bank loan	18,000	26,000
<b><u>Current liabilities</u></b>		
Trade payables	14,000	10,653
Overdraft (facility RM15 million)	14,750	12,019
Bank loan	8,000	8,000
Provision for redundancy costs	5,500	300

In addition, the engagement partner provided you with the following information:

- The company purchases discontinued goods from suppliers based throughout the world. All purchases are made on 30-day credit terms and are invoiced in the supplier's local currency.
- Recent trading conditions have been difficult for SAH because of the increase in the number of competitors offering comparable goods. The Malaysian Retail Consortium, a trade association for retailers, has forecasted difficult trading conditions for the sports retail sector for December 2020 and throughout 2021.
- SAH received criticism in the media for failing to deliver many orders placed on 27 November 2020 when further discounts were offered to customers shopping on SAH's website during the 'Black Friday' sale. Capacity issues in the warehouse meant that inventory held in the warehouse was insufficient to fulfil all the orders placed. In addition, the website failed to update inventory levels as goods were sold online, resulting in stock outs and some customers not receiving their orders.
- In October 2020, Ministry of Human Resources (MOHR) commenced an investigation into breaches by SAH of the Malaysian minimum wage legislation. Most SAH employees are paid the Malaysian minimum wage for the hours they work when their store is open to the public. However, they are required to work unpaid for an additional hour after the store has closed to prepare the store for the next day's trading. MOHR's view is that employees should be paid for this additional hour and has requested access to SAH's payroll records for the previous six years.
- On 1 November 2020, SAH's directors approved and announced a major reorganisation plan to return the company to profitable trading. The plan includes the closure of 40 stores. Approximately 20% of the workforce will be made redundant over the next 12 months through a voluntary redundancy programme. The directors have asked that employees apply for voluntary redundancy by 31 December 2020. Redundancy payments are calculated based on the employee's length of service and current wages. SAH is offering redundancy packages with terms that are more beneficial than the statutory rates set by the Malaysian government.

**Continued ...**

- The overdraft facility is due for review on 31 January 2021. The bank has requested audited financial statements by that date together with profit and cash flow forecasts for the five years ending 31 December 2025. The bank loan is repayable in quarterly instalments of RM2 million.
- SAH does not currently have an internal audit function. However, following the discovery of a theft of a material value of inventory at the warehouse, the board of directors decided to introduce such a function during the year ending 31 December 2021.

**Required:**

(a) Justify why item (1) going concern and (2) provision for redundancy costs have been identified as key areas of audit risk and for each risk, describe the audit procedures that should be included in the audit plan to address those risks. Present your answer in a two columns format using the following subheadings as below:

(24 marks)

(1) Going concern (Justification)	Going concern (Audit Procedures)
(2) Provision for redundancy costs (Justification)	Provision for redundancy costs (Audit Procedures)

(b) In respect of the directors' decision to introduce an internal audit function:

- List FOUR (4) performance indicators which could be used by the audit committee to monitor the quality of the internal audit function.
- If you plan to rely on its work to reduce the extent of the audit procedures you will carry out for the year ending 31 December 2021 audit, explain the relevant aspects of the internal audit work that you need to satisfy in order to be able to place the necessary reliance.

(6 marks)

(c) Assuming your firm concludes that there is an uncertainty about the going concern status of SAH, explain the potential implications for your firm's audit report for the year ended 31 December 2020 if the directors do not make appropriate disclosures.

(4 marks)

(Total: 34 marks)

**Continued ...**

**QUESTION 3 (14 marks)**

Your firm Griffin & Co (Griffin), an ICAEW firm of chartered accountants, is the external auditor of Daisy Gold (DG) Berhad, a listed company. DG employs 2,500 consultants and provides management consultancy services to clients throughout the world. All consultancy services are provided under fixed-price contracts.

You are the audit manager responsible for the audit of DG. You will be attending DG's forthcoming audit committee meeting with Hasman Yusri, the audit engagement partner. Hasman has provided you with a copy of the audit committee's agenda and has requested that you research each agenda item so that you are in a position to answer any questions.

An extract from the agenda is given below.

**Extract from the audit committee's agenda****(1) External auditor's report to those charged with governance following the audit for the year ended 31 October 2019.**

Griffin will present to the audit committee, a report to those charged with governance which highlighted the following internal control deficiencies:

- i. The company's policy requires that each month, contract managers compare the costs incurred to date and the expected costs to complete each contract with the total budgeted costs. This comparison was not made in 50% of the contracts examined by the auditors.
- ii. DG has signed a contract with Pinet Sdn. Bhd. (Pinet) to manage all of the consultants' transport arrangements. The contract requires that all airfares and hotels must be booked through the website recently developed by Pinet for this purpose.

However, some consultants claim that the website is often unreliable and is not user friendly. Consequently, consultants frequently book airline tickets and hotel rooms directly with the airline and hotel. They subsequently reclaim the cost from DG by submitting their receipts along with manual expense claim forms.

- iii. References were not always obtained when new consultants were employed. A large number of the consultants were hired without any background check.

**(2) Griffin's response to the invitation to provide review of the cash flow forecasts.**

Griffin is currently finalising its terms of engagement with DG for the requested non-audit services and will emphasize on 'the level of assurance that will not be the same as for an external audit engagement'.

**Continued ...**

**Required:**

(a) For each internal control deficiency listed as (i), (ii) and (iii) in agenda item (1), outline what should have been included in the report to those charged with governance regarding the possible consequence(s) of the deficiency and the recommendations to address the deficiency.

(10 marks)

(b) For agenda (2), explain how and why the level of assurance provided by the report on the cash flow forecasts differs from the level of assurance provided by an auditor's report on an external audit engagement.

(4 marks)

(Total: 14 marks)

**QUESTION 4 (20 marks)**

Your firm is an established audit firm and has six partners operating from two offices. Described below are situations which have arisen in respect of the provision of services by your firm to four external audit clients who are competitors within the same market sector.

**Gold Berhad (Gold)**

The engagement partner responsible for the audit of Gold, a listed company, was rotated after five years and immediately became the relationship partner with responsibility for managing the firm's overall relationship with the client.

**Silver Berhad (Silver)**

Silver has requested that your firm provides a member of staff to help with the preparation of the annual financial statements.

**Bronze Group Berhad (Bronze)**

Your firm audits the financial statements of Bronze, a listed company, and its wholly-owned subsidiary Kwik Berhad (Kwik). The audit fees for Bronze and Kwik are RM95,000 and RM47,000 respectively. In addition, your firm undertakes an annual taxation engagement for both companies with fees totalling RM45,000. During the current year, Bronze undertook a one-off consultancy engagement. The total fee for this engagement was RM129,000. Your firm's total annual fee income from all its clients is RM2,010,000.

**Platinum Berhad (Platinum)**

Your firm is to provide internal audit services for Platinum as the audit committee is unhappy with the performance of the firm currently providing these services.

**Continued ...**

**Required:**

(a) Identify and explain the threats to your firm's objectivity presented by each of the situations above and list the steps your firm should take to address those threats. (14 marks)

(b) Explain the ethical issues arising within your firm caused by acting for all four competitor companies identified above and outline the safeguards that your firm should have in place to address these issues. (4 marks)

(c) Explain why an external auditor of a company should be objective and independent. (2 marks)

(Total: 20 marks)

**QUESTION 5 (12 marks)**

Described below are four situations, which have arisen at four unrelated audit clients of your firm. The year end for each client is 30 June 2020.

**(a) Berlin Sdn. Bhd. (Berlin)**

The management of Berlin has refused to provide written representations that:

- all transactions have been recorded and reflected in the financial statements.
- it has provided the auditor with all the relevant information and access as agreed in the terms of the audit engagement.

**(b) Hamburg Sdn. Bhd. (Hamburg)**

Your firm is the external auditor of Hamburg for the year ended 30 June 2020. In March 2020, Hamburg sold a property to James Lucas. James is Hamburg's managing director. Hamburg's directors have refused to disclose the sale of the property to James in the financial statements for the year ended 30 June 2020 as they claimed that the amount is too immaterial to disclose.

**(c) Munich Bhd. (Munich)**

Munich is a company which was established to search for precious metals in Malaysia, but it has been unsuccessful. The directors of Munich intend to liquidate the company and therefore do not consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements. Munich's financial statements have been prepared on a break-up basis and adequate disclosure of this basis has been included in the notes to the financial statements. Munich has a number of shareholders and many suppliers who are unaware that the directors have taken the decision to liquidate the company.

**Continued ...**

**(d) Cologne Sdn. Bhd. (Cologne)**

Your firm is the external auditor of Cologne for the year ended 30 June 2020. Cologne 's financial statements show revenue of RM54.8 million, of which RM1.1 million relates to cash sales. During the audit, your firm identified that Cologne had no system of internal control over cash sales. No other audit procedures were available to obtain assurance over cash sales. Cologne's profit before tax is RM9.5 million.

**Required:**

For each of the four situations above, state with reasons, the implications for your firm's audit or assurance report.

(12 marks)

(Total: 12 marks)

**End of Paper**